

Internal Revenue Service

Number: **201424005**

Release Date: 6/13/2014

Index Number: 355.01-00, 368.00-00,
368.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:2

PLR-133997-13

Date:

March 06, 2014

Legend

Parent =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Sub 6 =

Sub 7 =

Sub 8 =

Sub 9 =

Sub 10 =

Distributing =

Controlled =

Merger Sub =

LLC 1 =

LLC 2 =

LLC 3 =

LLC 4 =

Acquirer =

Business A =

Business B =

a =

b =

c =

d =

e =

f =

g =

h =

i =

i =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

State A =

Dear :

This letter responds to your request dated August 1, 2013 for rulings on certain federal income tax consequences of the Transaction (defined below). The information in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party.

This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the transaction described herein: (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

Summary of Facts

Parent was a closely held State A corporation with a single class of common stock authorized and outstanding, and the common parent of an affiliated group of corporations that filed a consolidated federal income tax return. A majority of Parent's stock was held directly or indirectly by a shareholders (the "Principal Shareholders"). The Principal Shareholders held approximately b percent of Parent stock. The remaining shares were held by approximately c directors, officers, and employees of Parent. Approximately d percent of the shares were held by Parent's 401(k) Plan. Parent had an outstanding buy-sell agreement with each of its shareholders to buy back their Parent stock at a set formula price (the "Buy-Sell Agreements"). Otherwise shareholders were generally prohibited from selling Parent stock.

Prior to the Transaction, Parent had various loans and letters of credit with third parties. In addition, Parent also had a receivable due from Controlled of approximately \$e reflecting a series of advances Parent made to Controlled, a wholly-owned subsidiary, for its use in making acquisitions and working capital (the "Intercompany Receivable"). Additionally, Parent had issued loans to a number of its shareholders, which allowed the shareholders to purchase Parent stock as part of an executive retention and incentive plan (the "Shareholder Loans").

At the time of the Transaction, Parent wholly owned Sub 1 and Sub 2. Parent also wholly owned Sub 3 and Sub 4, which were dormant corporations. Additionally, Parent was involved in a number of joint ventures. Parent owned f percent of LLC 1 and g percent of LLC 2. Additionally, Sub 2 owned h percent of LLC 3.

At the time of the Transaction, Parent also wholly owned Controlled. Parent had acquired Controlled on Date 2 in a transaction that Parent represents qualified as a tax-

free reorganization under section 368. Controlled was a holding company that wholly owned LLC 4, which it had acquired on Date 1 (more than 5 years prior to the Transaction). LLC 4 was an entity disregarded from its owner (Controlled) for Federal income tax purposes. LLC 4 wholly owned Sub 5, which it acquired for cash on Date 3. Sub 5 wholly owned Sub 6, Sub 7, Sub 8, Sub 9, and Sub 10.

Distributing was the successor to Parent after the F Reorganization (defined below). Distributing and the members of its “separate affiliated group” as defined in section 355(b)(3) (the “Distributing SAG”) directly engaged in Business A and other business operations. Controlled and the members of its “separate affiliated group” as defined in section 355(b)(3) (the “Controlled SAG”) directly engaged in Business B. Financial information has been submitted indicating that each of Business A and Business B had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

On Date 4, Parent was approached by Acquirer with a proposal to acquire Parent. Because Acquirer’s business is closely related to Business A but is not related to Business B, as a precondition to the Merger (defined below), Acquirer requested that Parent divest itself of any direct or indirect interests in Business B, including its ownership of Controlled (the “Divestment Requirement”).

Distributing determined that the Transaction would serve the following corporate business purposes: (i) to ensure the financial stability of Parent and provide liquidity needed for Parent to fulfill the Buy-Sell Agreements and (ii) to enhance the success of Business A by allowing Parent to utilize certain assets and goodwill of Acquirer after the acquisition. These purposes, with the Divestment Requirement, constitute the “Corporate Business Purposes.”

Acquirer acquired Parent on Date 9 in a transaction that taxpayer represents qualified as a reorganization under section 368(a)(1)(A) (the “Merger”). Taxpayer further states that the Merger occurred as part of the same plan as the Distribution (defined below).

Parent, Distributing (or Acquirer, as Distributing’s successor after the Merger), Controlled and LLC 4 entered into certain agreements in connection with the Transaction (collectively known as the “Continuing Agreements”). The Continuing Agreements included (i) a separation agreement and (ii) a tax matters agreement, each of which requires each party to indemnify the other for certain pre-Distribution liabilities (the indemnification provisions of each are referred to as the “Contingent Liability Arrangements”). In addition, the Continuing Agreements included some commercial agreements for each party to supply each other with goods and services on an arm’s length basis.

Transaction

For what are represented to be valid business purposes and occurring pursuant to the same plan, Distributing engaged in the following series of transactions (together constituting the “Transaction”):

- 1) On Date 5, Parent formed Distributing as a wholly-owned subsidiary, and Distributing formed Merger Sub as a wholly-owned subsidiary.
- 2) On Date 6, Merger Sub merged with and into Parent (the “Parent Merger”). Each issued and outstanding share of Parent was converted into one common share of Distributing. As a result, Parent became a wholly-owned subsidiary of Distributing and the Parent Group became the Distributing Group. As part of the same plan, Parent converted into a limited liability company pursuant to State A law (the “Parent Conversion”) and elected to be treated as a disregarded entity (“Parent LLC”) for U.S. federal income tax purposes. The Parent Merger, together with the Conversion, constitute the “F Reorganization.”
- 3) The Shareholder Loans were paid in full as of Date 8. Payments made by shareholders on these loans are referred to as the “Shareholder Loan Payments.”
- 4) Distributing contributed the Intercompany Receivable to Controlled (the “Receivable Contribution”) on Date 8. Distributing also contributed \$i in cash to Controlled for working capital needs and to help fund the 401(k) Redemptions, (defined below) (the “Working Capital Contribution”). The Working Capital Contribution, together with the Receivable Contribution, constitute the “Contribution.”
- 5) On Date 7, Parent LLC exchanged its shares in Controlled for j common shares of Controlled in a reverse stock split (the “Reverse Stock Split”). After the Reverse Stock Split, Distributing and Controlled had the same number of common shares outstanding.
- 6) On Date 8, Parent LLC distributed all of the Controlled stock to Distributing.
- 7) On Date 8, Distributing distributed all of the Controlled stock to its shareholders, pro rata (the “Distribution”). This completed the separation of Business B from Distributing and its affiliates and satisfied the Divestment Requirement.
- 8) On Date 9, Distributing merged with and into a newly-formed limited liability company wholly owned by Acquirer in the Merger. Parent represents that the Merger qualified as a reorganization described in section 368(a)(1)(A) and that the amount of cash paid to Distributing shareholders in the Transaction did not exceed 20 percent of the total consideration received by the Distributing shareholders in the Merger. In connection with the Merger, the Controlled stock

held by the Parent 401(k) Plan was redeemed by Controlled so that Acquirer did not hold Controlled stock in its 401(k) Plan after the Merger (the “401(k) Redemptions”).

Representations

General

- (a) The Parent Merger and the Parent Conversion, together, in Step 2 qualified as a reorganization described in section 368(a)(1)(F).
- (b) The Reverse Stock Split in Step 5 qualified as a reorganization described in section 368(a)(1)(E).
- (c) The Merger in Step 8 qualified as a reorganization described in section 368(a)(1)(A).
- (d) The acquisition of Controlled on Date 2 qualified as a tax-free reorganization under section 368(a)(1)(B) and sections 368(a)(1)(A) and 368(a)(2)(E).

Contribution and Distribution

- (e) Any money, property, or stock contributed by Distributing to Controlled in the Contribution was exchanged solely for stock in Controlled.
- (f) The distribution of Controlled stock to Distributing’s shareholders in the Distribution was with respect to their ownership of Distributing stock.
- (g) Distributing and Controlled, and their respective shareholders, each paid their own expenses, if any, incurred in connection with the Contribution and Distribution.
- (h) At the time of the Distribution, no indebtedness was (and currently, no indebtedness is) owed by Controlled (or any entity controlled directly or indirectly by Controlled) to Distributing or a successor (or any entity controlled directly or indirectly by Distributing or a successor).
- (i) No part of the consideration distributed by Distributing in the Distribution was received by a Distributing shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (j) Parent (and its successor, Distributing) and Controlled each treated all members of its separate affiliated group (SAG, as defined in section 355(b)(3)(B)) as one

corporation in determining whether the requirements of section 355(b)(2)(A) regarding the active conduct of a trade or business are satisfied.

- (k) The five years of financial information submitted for Business A conducted by Parent (and its successor, Distributing) is representative of the present operations of the business, and there have been no substantial operational changes to the business since the date of the last financial statements submitted.
- (l) Neither Business A conducted by Parent (and its successor, Distributing) nor control of a corporation conducting this business was acquired during the five-year period ending on the date of the Distribution (five-year pre-distribution period) in a transaction in which gain or loss was recognized (or treated as recognized) in whole or part. Parent and its successor, Distributing, were the principal owners of the goodwill and significant assets of Business A throughout the five-year pre-distribution period and until the Merger, and Acquirer has been and will continue to be the principal owner following the Merger.
- (m) The five years of financial information submitted for Business B conducted by Controlled (through LLC 4) is representative of the present operations of the business, and there have been no substantial operational changes in the business since the date of the last financial statements submitted.
- (n) Neither Business B conducted by Controlled (through LLC 4) nor control of a corporation conducting this business was acquired during the five-year pre-distribution period in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Controlled was the principal owner of the goodwill and significant assets of Business B throughout the five-year pre-distribution period and will continue to be the principal owner following the Distribution.
- (o) Distributing (through Parent LLC) continued the active conduct of Business A, independently and with Parent LLC's separate employees, following the Distribution and until the Merger, and Acquirer (through Parent LLC) has continued the active conduct of Business A, independently and with Parent LLC's separate employees, since the Merger. There is no planned or intended substantial reduction in business activity for Business A.
- (p) Controlled (through LLC 4) has continued the active conduct of Business B independently and with its separate employees, following the Distribution. There is no planned or intended substantial reduction in business activity for Business B.
- (q) The total adjusted basis and the fair market value of the assets transferred by Distributing to Controlled in the Contribution each exceeded the sum of (i) the

total liabilities to be assumed (as determined under section 357(d)), if any, by Controlled and (ii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing from Controlled and transferred to Distributing's creditors in connection with the Contribution, if any.

- (r) Any liabilities assumed (as determined under section 357(d)) by Controlled in the Contribution had been incurred in the ordinary course of business and were associated with the assets transferred.
- (s) The total fair market value of the assets transferred to Controlled in the Contribution exceeded the sum of (i) the amount of any liabilities assumed (as determined under section 357(d)) by Controlled in connection with the Contribution, (ii) the amount of any liabilities owed to Controlled by Distributing that were discharged or extinguished in connection with the Contribution, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the Contribution. The fair market value of the assets of Controlled exceeded the amount of its liabilities immediately after the Contribution.
- (t) The aggregate fair market value of the assets Distributing transferred to Controlled in the Contribution exceeded the aggregate adjusted basis of those assets.
- (u) No investment tax credit determined under section 46 has been, or will be, claimed with respect to any property transferred by Distributing to Controlled in the Contribution.
- (v) The Distribution was carried out to facilitate the Corporate Business Purposes and the Distribution was motivated in whole or substantial part by the Corporate Business Purposes.
- (w) The Distribution was not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (x) The Distribution and the Merger were not effected for the purpose of, or with a view toward, facilitating any sale of Acquirer stock by a shareholder after the Merger, including by causing any shareholder to recognize gain as part of the Merger.
- (y) The amount of cash paid to Distributing shareholders in the Transaction did not exceed 20 percent of the total consideration received by the Distributing shareholders in connection with the Merger.

- (z) The issuance of cash in lieu of fractional shares of Acquirer common stock in the Merger was solely for the purpose of avoiding the expense and inconvenience of issuing fractional shares and does not represent separately bargained-for consideration. Total cash paid in lieu of fractional shares did not exceed one percent of the total consideration issued in the Merger to the Distributing shareholders. The fractional share interests of each Distributing shareholder were aggregated, and no Distributing shareholder received cash in an amount equal to or greater than the value of one full share of Acquirer common stock.
- (aa) Neither Parent nor its successor, Distributing, accumulated receivables nor made extraordinary payment of payables in anticipation of the Contribution and Distribution.
- (bb) No two parties to the Distribution were investment companies as defined in sections 368(a)(2)(F)(iii) and (iv).
- (cc) Immediately before the Distribution, items of income, gain, loss, deduction, and credit were taken into account as required by the applicable intercompany regulations (see Treas. Reg. §§ 1.1502-13 and -14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; Treas. Reg. § 1.1502-13 as published in T.D. 8597). Further, any excess loss account that Parent or a successor had in the Controlled stock or the stock of any direct or indirect subsidiary of Controlled was included in income immediately before the Distribution to the extent required by regulations (see Treas. Reg. § 1.1502-19). At the time of the Distribution, Distributing did not have an excess loss account in the stock of Controlled or the stock of any direct or indirect subsidiary of Controlled.
- (dd) Apart from the debt arising under the Continuing Agreements and intercompany loans or other obligations that have arisen in the ordinary course of business, no intercorporate debt existed at the time of the Distribution between Controlled (or any entity controlled directly or indirectly by Controlled) and Distributing or a successor of Distributing (or any entity controlled directly or indirectly by Distributing or a successor).
- (ee) Payments made in connection with all continuing transactions between Controlled (or any entity controlled directly or indirectly by Controlled) and Distributing or its successor, Acquirer (or any entity controlled directly or indirectly by Distributing or Acquirer), will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (ff) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) held stock possessing 50 percent

or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in sections 355(d)(5) and (d)(8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution. For this representation, purchases of Parent stock are treated as purchases of Distributing stock.

- (gg) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) held stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in sections 355(d)(5) and (d)(8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in sections 355(d)(5) and (d)(8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution. For this representation, purchases of Parent stock are treated as purchases of Distributing stock.
- (hh) Immediately after the transaction (as defined in section 355(g)(4)), no person held a 50-percent or greater interest in Controlled or Distributing or any successor of Distributing, and neither Distributing nor Controlled was a disqualified investment corporation (within the meaning of section 355(g)(2)).
- (ii) The Shareholder Loan Payments represented less than 20 percent of the fair market value of the stock of Controlled distributed in the Distribution.
- (jj) Distributing will recognize and include in income gain, if any, on the Distribution equal to the difference between the fair market value and basis of the Controlled stock immediately before the Distribution.

Rulings

Based solely on the information submitted and the representations set forth above, and provided that (i) the distribution of Controlled stock to Distributing's shareholders in the Distribution is with respect to their ownership of distributing stock, (ii) any money, property, or stock contributed by Distributing to controlled in the Contribution is exchanged solely for stock or securities in controlled, and (iii) any other transfer of stock, money, or property between Distributing, Controlled, or any Distributing shareholder and any person related to Distributing, Controlled, or any Distributing shareholder is respected as a separate transaction, we rule as follows:

- (1) The Contribution, followed by the Distribution, was a reorganization under section 368(a)(1)(D). Distributing and Controlled each was a “party to the reorganization” within the meaning of section 368(b).
- (2) No gain or loss was recognized by Distributing on the Contribution (sections 361(a) and 357(a)).
- (3) Distributing recognized gain (but not loss) on the Distribution equal to the difference between the fair market value and basis of Controlled stock immediately before the Distribution (sections 311(b) and 355(e)).
- (4) No gain or loss was recognized by Controlled on the Contribution (section 1032(a)).
- (5) The basis of each asset received by Controlled in the Contribution equals the basis of that asset in the hands of Distributing immediately before the Contribution (section 362(b)).
- (6) The holding period of each asset received by Controlled in the Contribution includes the period during which Distributing held that asset (section 1223(2)).
- (7) No gain or loss was recognized by (and no amount was otherwise included in the income of) the Distributing shareholders on the Distribution (section 355(a)(1)).
- (8) Immediately following the Distribution, the basis that each Distributing shareholder had in a share of Distributing stock before the Distribution was allocated between the share of Distributing stock with respect to which the Distribution was made and the share of Controlled stock received with respect to the share of Distributing stock in proportion to the fair market value of each in accordance with Treas. Reg. § 1.358-2(a) (sections 358(a) – (c)). If a Distributing shareholder that purchased or acquired shares of Distributing stock on different dates or at different prices is not able to identify which particular share of Controlled stock is received with respect to a particular share of Distributing stock, the shareholder may designate which share of Controlled stock was received with respect to a particular share of Distributing stock, provided the terms of the designation are consistent with the terms of the Distribution.
- (9) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution includes the holding period of the Distributing stock with respect to which the Distribution is made, provided the Distributing stock was held by the Distributing shareholder as a capital asset on the date of the Distribution. Section 1223(1).

- (10) Earnings and profits were allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. §§ 1.312-10(a) and 1.1502-33(e)(3).
- (11) Following the Distribution, Controlled was not a successor of Distributing for purposes of section 1504(a)(3). Therefore, Controlled and its direct and indirect subsidiaries that are “includible corporations” under section 1504(b) and satisfy the ownership requirements of section 1504(a)(2) are members of an affiliated group of corporations entitled to file a consolidated U.S. federal income tax return with Controlled as the common parent.
- (12) Any payments between Distributing and Controlled made following the Distribution pursuant to the Contingent Liability Arrangements regarding obligations that (i) arose for a taxable period ending on or before the Distribution or for a taxable period beginning before but ending after the Distribution and (ii) do not become fixed and ascertainable until after the Distribution, will be treated as occurring immediately before the Distribution (*cf. Arrowsmith v. Commissioner*, 344 U.S. 6 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84).

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express no opinion regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Distribution is being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); and
- (iii) Whether the Merger qualifies as a reorganization under section 368(a)(1)(A).

Procedural Statements

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Lisa A. Fuller
Branch Chief, Branch 5
Office of Associate Chief Counsel (Corporate)

cc: